

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 EUR-25 AF-10 SSO-00 NSCE-00 USIE-00

INRE-00 SS-15 NSC-10 L-03 AID-20 CIAE-00 COME-00

EB-11 FRB-02 INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07

OPIC-12 SPC-03 CIEP-02 LAB-06 SIL-01 OMB-01 STR-08

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FM AMEMBASSY CARACAS

TO SECSTATE WASHDC IMMEDIATE 1221

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DEPT PASS TO CHAIRMAN ARTHUR BURNS, FEDERAL RESERVE BOARD
FROM BRIMMER

E.O. 11652: GDS

TAGS: VE EFIN

SUBJECT: VENEZUELAN VIEWS ON INTERNATIONAL FINANCIAL SCENE

1. THERE FOLLOW MEMORANDA OF CONVERSATIONS OF FED GOV. ANDREW
BRIMMER WITH THE MINISTER OF FINANCE LUIS ENRIQUE OBERTO AND BOARD
OF DIRECTORS OF CENTRAL BANK OF VENEZUELA.

2. IN MY COURTESY CALL SEPTEMBER 14 ON VENEZUELAN FINANCE MINISTER
LUIS ENRIQUE OBERTO, HE INQUIRED WHETHER I FELT THERE WAS A
POSSIBILITY THAT NAIROBI MEETING WOULD TAKE CONCERTED ACTION TO
CURB RUNAWAY INTEREST RATES WHICH ARE A SERIOUS CAUSE OF CONCERN
HERE.

3. I SAID THAT WHILE YOU AND GOVERNOR DAANE WILL SPEAK FOR FEDERAL
RESERVE AT NAIROBI, MY OWN OPINION WAS THAT NO SUCH ACTION WAS
LIKELY. I SAID THAT I EXPECTED THAT THE FIRST PRIORITY WOULD BE
PLACED ON DEVISING A MECHANISM FOR BALANCE OF PAYMENTS ADJUSTMENTS.

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HE NOTED THE EUROPEAN CONCERN OVER THE CONVERTIBILITY ISSUE, AND
I POINTED OUT THAT U.S. RESERVE ASSETS ARE NOT SUFFICIENT TO SOLVE
THIS PROBLEM AT THIS TIME. I SAID THAT I WOULD EXPECT THAT OTHER
ISSUES WOULD ALSO BE DISCUSSED INCLUDING THE S.D.R. - DEVELOPMENT

ASSISTANCE LINK. I STRESSED THE NEED TO RESTORE CONDITIONS TO ENSURE REASONABLE EXCHANGE RATE STABILITY AND TO ESTABLISH MECHANISM TO FACILITATE ADJUSTMENT OF BALANCE OF PAYMENTS DISEQUILIBRIA.

4. OBERTO AGREED IN GENERAL, PUTTING EMPHASIS ON THE URGENCY OF SOLVING THE INTERNATIONAL FINANCIAL UNCERTAINTY WHICH IN HIS OPINION WAS CONTRIBUTING GREATLY TO PUSHING UP PRICES OF BASIC COMMODITIES. HE SAID THAT WHILE INFLATION IN THE PAST HAS BEEN A LOCALIZED PROBLEM, IT WAS NOW WORLDWIDE. HE ADDED THAT LOCALIZED INFLATION PROBLEMS ARE DIFFICULT ENOUGH TO CURE AND HE EXPRESSED CONCERN OVER THE GREATER DIFFICULTY OF RESTRAINING WORLDWIDE INFLATION. PHYSICAL SCARCITIES IN THE FACE OF RISING CONSUMPTION ACCOUNTED FOR PART OF THE INFLATION, BUT MONETARY INSTABILITY AGGRAVATED THE PROBLEM. HE SUGGESTED THAT ALL COUNTRIES MUST PLAY A PART IN SOLVING THE INTERNATIONAL MONETARY PROBLEM BUT THAT THE MAIN BURDEN INEVITABLY RESTED WITH THE MORE ADVANCED COUNTRIES.

5. ASKED WHAT HE THOUGHT U.S.G. SHOULD DO, OBERTO SAID THE MOST PRESSING NEED WAS TO MOVE QUICKLY TOWARD A REFORMED INTERNATIONAL MONETARY SYSTEM, ACCEPTING SHORTCOMINGS IN IT WHICH MIGHT BE CORRECTED DURING THE NEXT THREE TO FIVE YEARS. HE SAID IT WAS BETTER TO HAVE IN PLACE A BAD SYSTEM WHICH COULD BE IMPROVED RATHER THAN TO WAIT UNTIL SOMETHING RESEMBLING AN IDEAL SYSTEM MIGHT BE INSTALLED SOME YEARS HENCE. HE SAID THAT THE LOSS OF CONFIDENCE IN THE WORLD'S MAJOR CURRENCIES WAS ALREADY SO GREAT AS TO MAKE IT IMPERATIVE TO HAVE SERVICEABLE, IF NOT PERFECT, INTERNATIONAL ADJUSTMENT MECHANISM WITHOUT DELAY.

6. OBERTO SHARED MY HOPE THAT PUBLIC EXPECTATIONS OF RESULTS FROM NAIROBI WOULD NOT BECOME EXAGGERATED, LEADING TO SUBSEQUENT DISILLUSIONMENT.

7. OBERTO SAID THAT HE WILL BE UNABLE TO GO TO NAIROBI AS HE HAD PLANNED; VENEZUELAN DELEGATION WILL BE LED BY CENTRAL BANK PRESIDENT ALFREDO LAFEE, WHO WILL ALSO CHAIR MEETING OF 24 LDC'S.

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8. IN SUBSEQUENT MEETING WITH CENTRAL BANK PRESIDENT LAFEE AND SEVERAL CENTRAL BANK DIRECTORS, HE RAISED THE QUESTION OF CONCERTED ACTION TO CONTROL INTEREST RATES WITHOUT KNOWLEDGE OF MY PRIOR DISCUSSION WITH OBERTO. HE EMPHASIZED THAT RIGIDITY OF INTEREST RATES IN VENEZUELA AND STRESSED THE FACT THAT SENSITIVE CAPITAL TENDED TO FLOW OUT OF VENEZUELA IN SEARCH OF HIGHER RATES ELSEWHERE. IN REPLY TO QUESTION, HE AND HIS COLLEAGUES EXPLAINED THAT VENEZUELA IS IMPORTING INFLATION FROM ABROAD THROUGH HIGHER IMPORT COSTS ASSOCIATED WITH WORLDWIDE TENDENCY OF PRICES TO RISE AND WITH APPRECIATION OF EUROPEAN AND JAPANESE CURRENCIES, AND THAT AN INCREASE IN INTEREST RATES IN VENEZUELA TO CURB CAPITAL OUTFLOW WOULD MERELY ADD ANOTHER COST PUSH FACTOR TO LOCAL INFLATIONARY TREND. A

CENTRAL BANK DIRECTOR ADDED THAT HIGHER DOMESTIC INTEREST RATES WOULD IMPLY A DECLINE IN VALUE OF OUTSTANDING FIXED INTEREST PAPER AND EXPRESSED THE FEAR THAT THE VENEZUELAN PUBLIC WOULD MISINTERPRET THIS AND LOSE CONFIDENCE IN THE SOUNDNESS OF THIS PAPER.

9. LAFEE POINTED OUT THAT CENTRAL BANK RECENTLY TIGHTENED RULES GOVERNING ACCESS OF FOREIGN BUSINESSES TO LOCAL BANK CREDIT.

HE SAID THAT THIS WAS PART OF EFFORT TO ATTRACT MORE CAPITAL TO THE COUNTRY AND TO CHANNEL MORE BANK RESOURCES TOWARD LOCAL BUSINESSES WHICH CANNOT BORROW IN INTERNATIONAL MARKETS. LAFEE SAID THAT, WHILE THERE WAS A RETURN OF VENEZUELAN FUNDS FROM ABROAD IN 1971 AND 1972 BECAUSE OF UNCERTAINTIES OVER DOLLAR, STERLING AND OTHER CURRENCIES, THE LIQUIDITY WHICH THIS PROVIDED THE BANKING SYSTEM HAD NOW BEEN ABSORBED AND THE ECONOMY COULD NOT STAND A CONTRACTION OF BANK LIQUIDITY SUCH AS WAS TENDING TO RESULT FROM THE INTEREST RATE DIFFERENTIAL BETWEEN VENEZUELA AND ELSEWHERE.

10. ON INTERNATIONAL MONETARY REFORM, BOTH OBERTO AND LAFEE SAID THAT THE RECENT PARIS MEETING HAD BEEN DISCOURAGING AND THAT THEY WERE LESS OPTIMISTIC THAN EARLIER ABOUT OUTLOOK FOR PROGRESS AT NAIROBI. ONE CENTRAL BANK ADVISOR WONDERED ABOUT DOLLAR OVERHANG PROBLEM AND WE DISCUSSED ALTERNATIVES OPEN TO DOLLAR HOLDERS WHO FELT THEY HELD TOO MANY DOLLARS. I STRESSED, AS I HAD WITH OBERTO EARLIER, THE NEED TO DEVISE APPROPRIATE ADJUSTMENT MECHANISM BEFORE TACKLING CONVERTIBILITY ISSUE, BECAUSE OF PRESENT INSUFFICIENCY

OF U.S. RESERVE ASSETS. I SUGGESTED THAT PRESS REPORTS MAY HAVE PUT EXCESSIVE STRESS ON DIFFERENCES IN C-20 ON CONVERTIBILITY LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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ISSUE AND MAY HAVE OVERLOOKED EMERGING CONSENSUS IN OTHER REFORM AREAS.

11. LAFEE INDICATED THAT THE GROUP OF 24 DEVELOPING COUNTRIES MAY NOT BE AS CONCERNED OVER THE INTEREST RATE PROBLEM AS HE WAS, BUT THAT IT WAS A SERIOUS MATTER FOR VENEZUELA. I TOLD HIM THAT I WOULD INFORM YOU AND GOVERNOR DAANE OF HIS CONCERN ABOUT THE IMPACT OF FOREIGN INTEREST RATE DEVELOPMENTS ON VENEZUELA.

12. COMMENTING ON RECENT UPSURGE OF INFLATIONARY PRESSURES IN VENEZUELA, LAFEE SAID THAT PRICE INCREASES HAD NOT YET BECOME INTOLERABLE, BUT THAT MEASURES TO CURB INFLATION, BOTH FROM THE FISCAL AND THE MONETARY SIDES, WERE BEING CONSIDERED. HE SAID THAT THESE WOULD NOT TAKE EFFECT BEFORE EARLY 1974. HE STRESSED THE DIFFICULTY OF MOVING AGAINST INFLATION IN AN ELECTION YEAR. FISHER

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